82-1142
No.

IN THE

Supreme Court of the United States

OCTOBER TERM 1982

SHARON STEEL CORPORATION, et al.,

Petitioners,

—v.—

THE CHASE MANHATTAN BANK, N.A., et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether Federal Courts should imply substantive terms into trust indentures, as was done here by the Second Circuit, or whether the rights and obligations of debentureholders and issuers of debentures are restricted to those explicitly set forth in trust indentures, a long-standing rule recently endorsed by the Fifth Circuit sitting in banc.

LISTING OF PARTIES

Petitioners in addition to Sharon Steel Corporation include:

UV Industries, Inc., and David Finkelstein, Arthur R. Gralla, Martin Horwitz, Edwin Jacobson, Theodore W. Kheel and Paul Kolton, as Trustees of the UV Industries, Inc. Liquidating Trust.

Respondents in addition to The Chase Manhattan Bank, N.A., include:

Manufacturers Hanover Trust Company, Union Planters National Bank of Memphis, Connecticut Mutual Life Insurance Company, The Mutual Life Insurance Company of New York, Connecticut General Life Insurance Company, The Penn Mutual Life Insurance Company, Union Dime Savings Bank, IDS Life Insurance Company, IDS Life Insurance Company of New York, Anchor National Life Insurance Company, Bankers Life Insurance Company of Nebraska, Phoenix Mutual Life Insurance Company, United Benefit Life Insurance Company, Life Insurance Company of North America, American National Insurance Company, Standard Life and Accident Insurance Company, General American Life Insurance Company, Monumental Life Insurance Company, Monarch Life Insurance Company, Country Life Insurance Company, Western Life Insurance Company, and Volunteer State Life Insurance Company.

LISTING UNDER SUPREME COURT RULE 28.1

As required by Supreme Court Rule 28.1, set forth below is a listing of the parent companies, subsidiaries (except wholly-owned subsidiaries) and affiliates of petitioner Sharon Steel Corporation:

Alaska Gold Company

APL Corporation

Bamco GmbH

Birdsboro Corporation

DWG Corporation

Laypsa S.A.

Leon Water Enterprises, Inc.

National Propane Corporation

NVF Company

NVF Europe S.A.

Pennsylvania Engineering Corporation

Pensa S.A.

Public Gas Company

Richmond-Eureka Mining Company

Ruby Hill Mining Company

Security Management Corporation

Steel Corporation of Texas

Southeastern Public Service Company

Universal Housing & Development Corporation

Wilson Brothers

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Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on September 28, 1982.

OPINIONS BELOW

The opinion of the Court of Appeals, reported at 691 F.2d 1039 (2d Cir. 1982), appears in Appendix A hereto. The opinions of the District Court for the Southern District of New York, reported at 521 F. Supp. 104 (S.D.N.Y. 1981) and 521 F. Supp. 118 (S.D.N.Y. 1981), appear respectively in Appendix B and Appendix C hereto.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on September 28, 1982. A timely petition for rehearing with a suggestion for rehearing in banc was denied on November 12, 1982. (The order denying the petition is attached as Appendix E hereto.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

Background

The central issue in this action is whether petitioner Sharon Steel Corporation ("Sharon Steel") is entitled to become the successor obligor on approximately $107,000,000 of long-term, low-interest debt incurred over a period of time by petitioner UV Industries, Inc. ("UV") pursuant to four separate trust indentures and lease guaranties (the "Indentures"), or whether the debt must instead be repaid now. Such repayment would permit the holders of the debt to re-invest the proceeds at today's higher interest rates. The respondents are four banks which acted as indenture trustees under the Indentures (the "Indenture Trustees") and a group of twenty institutional investors (nineteen insurance companies and one bank) which intervened in this action and are holders of approximately $47,000,000 of debentures issued pursuant to one of the Indentures (the "Intervenors"). (As institutional investors, the Intervenors hold very large portfolios of bonds and debentures issued pursuant to both public and private indentures[1] and, consequently, have a significant interest beyond the scope of

1 For example, as of December 31, 1980, respondent Penn Mutual Life Insurance Company reported approximately $1,107,000,000 in debentures and bonds in its portfolio and respondent Connecticut Mutual Life Insurance Company reported approximately $1,295,000,000. As of December 31, 1981, respondent Mutual Life Insurance Company of New York reported approximately $396,338,000 of such holdings.

this action in seeking expansion of the rights of debenture-holders and bondholders.)

More specifically, at various times between 1965 and 1977, UV incurred long-term debt obligations by the issuance of bonds and debentures (the "Debentures") due at various times ranging to 1997. By November 1979, there remained outstanding approximately $107,000,000 in principal amount of bonds and debentures which had been issued pursuant to the four Indentures. Each of these Indentures contains a standard provision (hereinafter referred to as the "standard successor obligor provision") which requires and entitles a corporation that purchases "all or substantially all" of UV's assets to succeed to UV's debt obligations.[2]

On November 26, 1979, Sharon Steel purchased all UV's assets for approximately $518,000,000 in cash and securities, assumed UV's liabilities (with exceptions not relevant here) and asked the Indenture Trustees to recognize it as UV's successor obligor.[3] At the time of the purchase and Sharon Steel's request to the Indenture Trustees, UV had made every regular payment of interest and principal on the Debentures and no default of any type had occurred under any of the Indentures. (Thereafter, Sharon Steel continued to make all such payments while this matter was being litigated.) In short, when Sharon Steel purchased all UV's assets on November 26, 1979, the Indentures were viable and ongoing contracts with all of their provisions in full force and effect, including the standard successor obligor provisions, which allowed, indeed required, the purchaser of all or substantially all UV's assets to succeed to UV's indenture obligations.

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2 The standard successor obligor provisions of each of the Indentures are quoted in full in the Court of Appeals' opinion. 691 F.2d at 1043-44 nn.4-7; App. A at 7a-10a nn.4-7.

3 Upon acquiring UV's assets, Sharon Steel had assets of $1,110,779,000 and a net worth of $257,300,000.

The Indenture Trustees refused to recognize Sharon Steel as the successor obligor. They contended that, because UV had eight months previously adopted a voluntary liquidation plan and sold a large amount of assets[4] before the sale to Sharon Steel, Sharon Steel did not purchase "all or substantially all" of UV's assets and that the sale to Sharon Steel constituted a default under the Indentures. (UV was a highly successful company and not in financial difficulty. It adopted the liquidation plan for independent business reasons. The Indenture Trustees conceded that the adoption of the liquidation plan was not a default under the Indentures.[5])

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4 The primary asset disposed of was Federal Pacific Electric Company ("Federal"), a wholly-owned subsidiary of UV which was sold on March 29, 1979. Federal constituted approximately 44% of the book value of UV's assets at that time. From the proceeds of the sale of Federal for $345 million, UV made an initial liquidating distribution of $274 million and kept the remaining $71 million. UV also sold certain oil and gas properties for approximately $135 million but retained all the proceeds, which were part of the assets bought by Sharon Steel on November 26, 1979. With the single exception of the initial liquidating distribution, the assets Sharon Steel acquired on November 26, 1979 included all the assets UV held when it adopted the voluntary liquidation plan or the proceeds from the sale of those assets. It was conceded below that no provision of the Indentures was breached by these sales or by the liquidating distribution.

5 Indeed, neither of the courts below found that any default existed under the Indentures prior to November 26, 1979, and the Indenture Trustees admitted the absence of any such default. For example, Manufacturers made the following admission in June 1979 in a letter to one of its Debentureholders:

> "In our opinion and in the opinion of our counsel, neither the approval by stockholders [of UV] of the Plan of Liquidation and Dissolution, nor the initial liquidating dividend constitutes a default under the Indentures. Nor are we aware of any other act or omission on the part of UV which constitutes a default under the Indenture. Absent a default under the Indenture, neither the Trustee nor the Debentureholders can, in our opinion, require UV to call the Debentures or in any other way compel payment of the Debentures other than in accordance with the terms of the Debentures and of the Indenture." 691 F.2d at 1046 n.11; App. A at 13a n.11.

Sharon Steel then commenced the present action to compel the Indenture Trustees to recognize it as UV's successor obligor. The jurisdiction of the District Court was based on the diversity of citizenship of the parties and on claims arising under the federal antitrust laws.

The Proceedings Below

The action was tried before a jury in the United States District Court for the Southern District of New York. At the close of Sharon Steel's case, the District Court dismissed Sharon Steel's claims (521 F. Supp. 104; App. B at 33a) and granted summary judgment in favor of the Intervenors and Indenture Trustees (521 F. Supp. 118; App. C at 56a). A judgment was entered on August 18, 1981 (App. D at 74a) requiring, *inter alia*, repayment of the $107,000,000 in outstanding principal.

The judgment was appealed to the United States Court of Appeals for the Second Circuit. In an opinion dated September 28, 1982 (App. A), the Second Circuit affirmed the District Court's judgment for the outstanding principal amount of the Debentures, holding that the standard successor obligor provisions contained in the Indentures

> "do not permit assignment of the public debt to another party in the course of a liquidation unless 'all or substantially all' of the assets of the company at the time the plan of liquidation is determined upon are transferred to a single purchaser." 691 F.2d at 1051; App. A at 26a.

Sharon Steel petitioned for a rehearing and suggested that, in light of the Fifth Circuit's in banc decision in *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (in banc), *cert. denied*, 454 U.S. 965 (1981), the rehearing be before the Second Circuit in banc. That petition was denied on November 12, 1982 (App. E at 85a).

REASONS FOR GRANTING THE WRIT

The Second Circuit's opinion represents an unprecedented and unwise way of dealing with trust indenture disputes. This new approach expressly rejects a literal reading of indenture language in favor of a wide-range policy analysis that has, and cites, no support in the authorities. Such a policy-analysis approach, which results here in the implication of substantive contractual terms, might be appropriate in other areas of the law. It is unsuitable, however, to an area of the law that demands certainty and predictability, that has heretofore been treated as being governed by the literal meaning of contractual terms, and that as a result has been largely self-regulating.

The policy-analysis approach of the Second Circuit invites a substantial and undesirable upsurge of litigation in this area of the law. There are, of course, many thousands of outstanding trust indentures governing billions of dollars of outstanding debentures and bonds held by untold thousands of corporations and individuals. In the last eight years alone over $300 billion have been loaned to American corporations in return for debentures and bonds.[6] Parties aggrieved by the literal meaning of indenture language—of which there will be no shortage—will now be strongly encouraged by the Second Circuit's opinion to try their chances in the Federal courtroom.

Moreover, as we explain below, the Second Circuit's policy analysis is largely premised on assertions that are demonstrably incorrect.

Recently, twenty-four judges of the Fifth Circuit sitting in banc vacated a panel decision and expressly endorsed, in an exhaustive opinion, the traditional approach of reading indenture language literally. *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (in banc), *cert. denied,* 454 U.S. 965

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6 Bureau of the Census, United States Department of Commerce, *Statistical Abstract of the United States*, § 17 Banking, Finance & Insurance, No. 879, at 524 (102d ed. 1981).

(1981) (hereinafter "*Broad v. Rockwell*"). We submit that there is no sound basis in law or policy for the radically different approach adopted by the Second Circuit, that the conflict between these two Circuits will necessarily cause disparity, confusion and unpredictability, and that as a result, the efficient working of the capital markets will be impaired.

The implication of substantive terms into trust indentures is a new arena into which other Federal Courts will or will not venture, depending on the guidance they receive from this Court.

The involvement of this Court is warranted not simply because of the conflict created by the Second Circuit's bold departure, but also because in recent years, the seeds for a burgeoning of litigation concerning trust indentures, including disputes as to implied rights of action under the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa *et seq.*, have been sowed in various other Federal Court decisions.[7] Such decisions are also notable for their lack of consistency. *See infra* at 15. We submit that now is the time for this Court to become involved and to shape and limit the development of the law—and litigation—in this area.

In light of these factors, as well as the enormous amount directly at stake in this dispute, we respectfully urge this Court to review the decision below.

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7 *See, e.g.*, *Pittsburgh Terminal Corp. v. Baltimore & Ohio Railroad Co.*, 680 F.2d 933 (3d Cir. 1982), *cert. denied*, 51 U.S.L.W. 3409 (U.S. Nov. 29, 1982); *Zeffiro v. First Pennsylvania Banking & Trust Co.*, 623 F.2d 290 (3d Cir. 1980), *cert. denied*, 102 S. Ct. 2295 (1982); *Van Gemert v. Boeing Co.*, 520 F.2d 1373 (2d Cir.), *cert. denied*, 423 U.S. 947 (1975), *appeal after remand*, 553 F.2d 812 (2d Cir. 1977); *Morris v. Cantor*, 390 F. Supp. 817 (S.D.N.Y. 1975).

I.

THE SECOND CIRCUIT RADICALLY AND UNWISELY DEPARTS FROM EXISTING INDENTURE LAW BY IMPLYING SUBSTANTIVE TERMS

A. Rights and Obligations Must Be Established in the Indenture Contract

The significance of indentures and their proper interpretation to the corporate and investment communities cannot be over-estimated. Long-term debt issued pursuant to indentures is part of the life-blood of American industry.

It has long been recognized that the creditor/debtor relationship established by the issuance of long-term debt pursuant to an indenture is a creature of contract and that the controlling contract is the indenture. As noted in the American Bar Foundation's *Commentaries on Model Indenture Provisions* (1971) (the "*Commentaries*"), at 2, there is no governing body of statutory or common law to which debentureholders may turn, and thus their rights must be established "through contractual provisions set forth in the debt agreement or indenture. . . ."

Because these contracts must establish the rights and obligations of debtor and creditor over a period of many years, they are usually quite lengthy, and they "attempt to anticipate and deal with in advance all possible contingencies that might call into question the operation of those rights and obligations." *Broad v. Rockwell, supra*, 642 F.2d at 941; *see Parkinson v. West End Street Railway Co.*, 173 Mass. 446, 53 N.E. 891 (1899) (Holmes, J.).

When indenture contracts are entered into, it is clear that the long-term relationship thus established may be buffeted by many changes in the obligor's operational and financial condition, not to mention significant changes in the nation's economic climate. Nevertheless, any rights to be asserted during the long life of the relationship must be established with

specificity at the outset in the indenture contract. In short, if protection is desired against future actions that the corporate obligor might take over the long life of an indenture, it "must be provided by contract if it is to be provided at all." *Broad v. Rockwell, supra,* 642 F.2d at 943.

B. The Traditional Approach of the Courts Has Served the Need for Certainty

When changed circumstances (such as a precipitous rise in prevailing interest rates) spark a dispute between the parties to an indenture contract, the courts are presented with a strong temptation to rewrite the contract in a manner believed equitably to account for such new circumstances. Until the Second Circuit's opinion in the present action, the courts have for nearly a century resisted this temptation. *See, e.g., Broad v. Rockwell, supra*, 642 F.2d at 947, 956; *Lisman v. Milwaukee, Lake Shore & Western Railway Co.*, 161 F. 472 (C.C.E.D. Wis. 1908), *aff'd mem.*, 170 F. 1020 (7th Cir.), *cert. denied*, 214 U.S. 520 (1909); *Parkinson v. West End Street Railway Co., supra*, 173 Mass. 446, 53 N.E. 891; *Kessler v. General Cable Corp.*, 92 Cal. App. 3d 531, 539, 544-45, 155 Cal. Rptr. 94, 100, 103 (Cal. Ct. App. 1979); *Levine v. Chesapeake & Ohio RR. Co.*, 60 A.D. 2d 246, 400 N.Y.S. 2d 76 (1st Dep't 1977).

This classic rule of indenture law was reiterated in the Fifth Circuit's in banc decision in *Broad v. Rockwell*:

> "It is not the function of a court to rewrite a contract's terms in the process of 'interpretation' to make them accord with the court's sense of equity." 642 F.2d at 956.

The rationale behind this rule is not difficult to discern and, in fact, was alluded to in the Second Circuit's opinion: a high degree of certainty is necessary for the "efficient working of capital markets." 691 F.2d at 1048; App. A at 19a. The Second Circuit cited this need for certainty as a reason why standard indenture provisions must be interpreted by judges rather than juries. The opinion seems not to recognize, however, that this

need must also constrain judges. After all, parties must "adjust their affairs," *id.*, according to the specific provisions of trust indentures. These parties include—in addition to debenture-holders, obligors and trustees—banks extending short-term credit to an obligor, subsequent long-term lenders, underwriters and other companies which may participate in any type of corporate transaction with an obligor.

Each of these persons or entities is entitled to a greater degree of certainty than that offered by the Second Circuit. They are entitled to the certainty on which they have come to rely after decades of experience: the certainty that the language of an indenture means exactly what it says, and that an indenture will not be distorted to meet the exigencies of an unusual fact situation.

That is precisely the certainty which is impaired by the Second Circuit's decision. The certainty that the Second Circuit says is inherent in the guarantee that the judiciary, and not juries, will interpret standard indenture language is illusory unless the judiciary holds itself to the traditional standard. This is illustrated by comparing the Second Circuit's decision to the Fifth Circuit's in banc decision in *Broad v. Rockwell*.

C. *Broad v. Rockwell* and the Instant Case Conflict

The Fifth Circuit, noting that the indenture in issue "was drafted to provide, insofar as humanly possible, for every imaginable contingency," 642 F.2d at 951, rejected the notion that it was empowered to rewrite the indenture by implying rights or restrictions under the guise of "interpretation" or equity. *Id.* at 947, 956. Rather, it stressed the fundamental necessity and importance of interpreting indentures strictly to give the "words and phrases employed in the contract their plain meaning." *Id.* at 948. Using that approach, the Fifth Circuit found that no protection against a cash merger was specifically included in the indenture, although it clearly could have been, and refused to rewrite the contract to confer such protection. *Id.* at 952-53. The Fifth Circuit's detailed analysis

of the indenture provisions, *id.* at 948-55, stands in stark contrast to the Second Circuit's disregard for the language of the Indentures in the case at bar. *See* 691 F.2d at 1049; App. A at 21a.[8]

In the present case the Second Circuit has rewritten the Indentures, apparently "to accord with its instinct for the dispensation of equity under the facts of this case." 642 F.2d at 947.[9] The Indentures simply give no significance to the adop-

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8 Each of the Indentures in issue provides that UV may dispose of its assets by merger, consolidation or by selling all or substantially all of its property to another corporation, provided that successor corporation assumes UV's obligations under the Indenture. None of the Indentures says that "all or substantially all" refers to a quantum of assets other than that which exists on the date of the sale. Nor so far as we know has it ever before been claimed that this phrase in successor provisions of indentures refers to some other date. This is hardly surprising since the sentence in which the phrase occurs speaks on its face in the present tense.

At trial Sharon Steel presented the testimony of a renowned indenture expert, who was a member of the American Bar Foundation's steering and advisory committees which oversaw the publishing of the *Commentaries*. He testified that in fifty years of practice he had never known the phrase "all or substantially all" in the standard successor provision to refer to anything other than the assets existing on the day of the sale to the would-be successor. Trial Transcript at 1088-89.

That the plain and literal meaning of the standard successor obligor provisions is as Sharon Steel contends is established not only by the language used but also by the context in which it is employed. The same provision, after all, refers to two other types of transactions—mergers and consolidations—which by definition involve all the assets of the company on the day of the transaction, not some unspecified date in the past.

9 The conflict inherent in the approach to indenture law taken by the Second and Fifth Circuits permeates the two opinions. For example, in *Broad v. Rockwell* the court noted that corporate transactions such as mergers, sales of assets, dissolutions and liquidations may well dilute debentureholders' conversion rights but concluded that protection against such transactions must be provided by contract if it is to be provided at all. 642 F.2d at 943 (citing *Parkinson v. West End Street Railway Co.*, 173 Mass. 446, 53 N.E. 891 (1899)(Holmes, J.)). In the present action, the Second Circuit apparently viewed the fact that such transactions may downgrade the value

tion of a plan of voluntary liquidation, although other indentures specifically provide that adoption of such a plan is an event of default. The Indenture Trustees do not contend that adoption of the liquidation plan was a default. *See* 691 F.2d at 1046 n.11; App. A at 13a n.11. The adoption of such a plan was, in the words of a case prominently relied upon by the Fifth Circuit in *Broad v. Rockwell*, "only one of several vicissitudes liable to happen during . . . the life of the corporation . . . which the debenture holders were . . . bound to anticipate." *Lisman v. Milwaukee, Lake Shore & Western Railway Co., supra*, 161 F. at 478.

Similarly, the Indentures do not use the explicit language that every indenture lawyer knows must be used when a reference back to prior asset sales is intended. The *Commentaries* themselves contain a sample of such language, which specifically refers to considering present asset sales "*together with all prior*" sales. *Commentaries* at 426-27 (emphasis added).

The parties could have provided in these Indentures, as is provided in other indentures, that adoption of a plan of voluntary liquidation is a default—but they did not. They could have used the "together with all prior" sales language—but they did not. In the phrase of Justice Holmes in *Parkinson*

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of the debtholders' investment as a reason for implying restrictions not provided in the indenture contract. 691 F.2d at 1050-51; App. A at 23a-25a.

In reaching its decision in *Broad v. Rockwell*, the Fifth Circuit acknowledged that there were at least three types of indenture provisions which could have been used to prevent dilution of conversion rights, and noted that there would be no unfairness in denying debentureholders protection if such provisions were not included in the indenture. 642 F.2d 929. In the present action, the Second Circuit was apprised of numerous covenants that could have easily provided the debentureholders here the protection against dissipation of assets they now seek. None of those was included in the Indentures. Instead of following the lead of the Fifth Circuit, however, the Second Circuit perceived the omissions of available protections as its cue to include by implication that which the parties clearly did not include as part of their contractual bargain.

v. West End Street Railway Co., *supra*, 173 Mass. at 449, 53 N.E. at 892 (a case also given great weight in *Broad v. Rockwell*), the law provides the "machinery" for the protection now sought, but that "machinery" was not used. That the parties did not incorporate it in the language of the Indentures is not an invitation for the courts to do so.

The Second Circuit has, unlike the Fifth Circuit, ignored the language of the contracts in issue, has criticized Sharon Steel for taking a "literalist" approach, 691 F.2d at 1049; App. A at 21a, and has instead reached a determination based on a broad policy analysis. Referring to the indenture language only to conclude that the words cannot mean what they actually say, the Second Circuit has unabashedly implied a substantive term into the Indentures, *i.e.*, that the "all or substantially all" language refers to the quantity of assets held by an obligor on the day a plan of liquidation is determined upon. 691 F.2d at 1051; App. A at 26a.

As noted below, *infra* at 15, the conflicting approaches of the Fifth and Second Circuits have also caused confusion in the Third Circuit. *See Pittsburgh Terminal Corp. v. Baltimore & Ohio Railroad Co.*, 680 F.2d 933 (3d Cir. 1982), *cert. denied*, 51 U.S.L.W. 3409 (U.S. Nov. 29, 1982) (hereinafter *"Pittsburgh Terminal"*). What certainty is there when three of this country's most important courts cannot agree on a basic approach to indenture interpretation? How are parties to "adjust their affairs" to comport with various indenture requirements when those requirements can no longer be reliably discerned from the plain meaning of the language employed, but must be divined from various and shifting notions of policy held by various courts across the land? The answer is that the policy-analysis approach adopted by the Second Circuit, unlike the literalist approach of the Fifth Circuit, is inconsistent with the very need for certainty that the Second Circuit purported to serve. This approach is also inconsistent with the policy of the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa *et seq.*, to promote uniformity in the field of trust indentures.

The Second Circuit's bold departure in the instant case was perhaps foreshadowed to some degree by its opinion in *Van Gemert v. Boeing Co.*, 553 F.2d 812 (2d Cir. 1977), *on appeal after remand from* 520 F.2d 1373 (2d Cir.), *cert. denied*, 423 U.S. 947 (1975). There the Second Circuit held that the obligor had given inadequate notice of a forced redemption of convertible debentures to allow the holders a meaningful opportunity to exercise the conversion feature, and that this failure constituted a breach of the covenant of good faith and fair dealing (*i.e.*, not to do anything to prevent the other party from enjoying the fruits of the contract) that is implied in every contract. 553 F.2d at 815.

Van Gemert was not relied on by the Second Circuit here and is not relevant for at least two reasons. First, the instant case does not involve—and neither the adverse parties nor the courts below have ever asserted that it involves—any breach of any implied covenant of good faith and fair dealing. Second, as the Fifth Circuit observed in *Broad v. Rockwell* in distinguishing *Van Gemert*, the "loss" alleged by the holders in *Van Gemert* resulted from "administrative procedures" in the indenture that the court found unsatisfactory, and the case—unlike the instant case and *Broad v. Rockwell*—did not turn "on the question of substantive rights that are basic to the nature of the contract." 642 F.2d at 958. Indeed, what the Fifth Circuit said in *Broad v. Rockwell* to distinguish *Van Gemert* is especially applicable here, *mutatis mutandis*:

> "The risk of merger [or, here, of a sale of assets to a successor obligor after having previously sold other assets] was inherent in the investment made by the holders of Debentures. Rockwell and the Trust Company did nothing that could be described as 'destroying or injuring the right of the other party to receive the fruits of the contract,' because . . . the benefits that the holders of Debentures received were all the rights to which they were contractually entitled. Indeed, had Rockwell conferred on the holders of Debentures rights significantly greater than those set out in the Indenture, it might have faced claims

by its own shareholders for waste and corporate mismanagement." 642 F.2d at 958.

While *Van Gemert* is thus inapposite here, it is noteworthy that even its limited holding involving implication of administrative procedures has already caused considerable disagreement among judges in the Fifth and Third Circuits. *Compare Broad v. Rockwell,* 614 F.2d 418, 429-30 (5th Cir. 1980) (panel decision), *vacated and reheard in banc,* 642 F.2d 929 (5th Cir.), *cert. denied,* 454 U.S. 965 (1981), *with Broad v. Rockwell, supra,* 642 F.2d at 957-58 (in banc decision), *and compare Pittsburgh Terminal, supra,* 680 F.2d at 941 (majority opinion), *with* 680 F.2d at 951-52 (dissenting opinion).[10] If it should now become the law that *substantive* terms may be implied into indentures, it is likely that such disagreement will proliferate throughout the Federal judiciary.

D. The Second Circuit's Opinion Will Breed Litigation

Moreover, the uncertainty engendered by the Second Circuit's decision will no doubt breed litigation. The many parties whose interests may not be served by the literal meaning of indenture language will take hope that what cannot be found

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10 The confusion resulting from the conflicting approaches of the Second and Fifth Circuits was particularly evident in *Pittsburgh Terminal.* One of the issues in *Pittsburgh Terminal* was whether the obligor had a duty under the indenture to give the debentureholders advance notice of a distribution of stock. Judge Gibbons, writing for the majority, relied on *Van Gemert* to conclude that such notice was required by the implied covenant of good faith. 680 F.2d at 941. Judge Garth, concurring in the result on other grounds, found it unnecessary to reach the indenture issue. *Id.* at 943. Judge Adams, who addressed most of his dissenting opinion to the indenture issue, relied on *Broad v. Rockwell* to find that no advance notice requirement existed. *Id.* at 949. He refused to imply notice requirements beyond those contained in the indenture:

> "Virtually every modern commentator appears to agree with the *Broad* court that . . . debenture holders have no cause to complain about legal corporate conduct that adversely affects the value of the [investment] unless such conduct has been explicitly proscribed or otherwise addressed in the debenture indenture." *Id.* at 948.

within the four corners of their indenture contracts will be implied into the contracts by the Federal Courts.

It is precisely this search for solutions dehors the indenture contract that has heretofore been avoided in the indenture field—with good reason.

To paraphrase Judge Adams' dissent in *Pittsburgh Terminal*:

> "For this Court today—[many] years after the drafting of the [I]ndenture[s]—to ignore what was set forth as the intent of the parties and fundamentally to alter the terms of the contract is . . . not only legally erroneous but improvident." 680 F.2d at 954.

II.

THE SECOND CIRCUIT'S OPINION IS PREMISED ON ASSERTIONS THAT ARE DEMONSTRABLY ERRONEOUS

In ignoring the Indentures' language and carrying out its policy analysis, the Second Circuit has grounded its opinion on assertions that are clearly erroneous.

A. A Literal Reading Supports Sharon Steel's Position and Does Not, as the Second Circuit States, "Prove Too Much"

The Second Circuit apparently agreed that Sharon Steel's position comports with a literal reading of the successor obligor provision. 691 F.2d at 1049; App. A at 21a.[11] However, the Second Circuit went on summarily to reject this approach

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11 Sharon Steel argued on appeal that as long as there is no default under any other restrictions in an indenture on a given date, the successor obligor provision is applicable when a would-be successor purchases all the property the obligor possesses on that date. Absent a default, an indenture is a valid and ongoing contract which applies to an obligor as it exists in the present. Debentureholders have no security interest in particular assets of an obligor and have no right as to assets previously disposed of, absent a specific provision establishing such a right.

in a pivotal paragraph, which contains a significant error that seems to provide the conceptual gate through which the court proceeded to its erroneous policy analysis. That paragraph reads as follows:

> "Sharon's literalist approach simply proves too much. If proceeds from earlier piecemeal sales are 'assets,' then UV continued to own 'all' its 'assets' even after the Sharon transaction since the proceeds of that transaction, including the $107 million cash for cash 'sale,' went into the UV treasury. If the language is to be given the 'literal' meaning attributed to it by Sharon, therefore, UV's 'assets' were not 'sold' on November 26 and the ensuing liquidation requires the redemption of the debentures by UV. Sharon's literal approach is thus self-defeating." *Id.*

Contrary to the above statement, a literal reading of the successor obligor provision does not require, nor even allow, such an absurd result. It is important to remember that the standard successor obligor provision does not apply to sales of less than substantially all a company's assets; it only comes into play when a transfer of "all or substantially all" an obligor's assets occurs. Thus, if an obligor sells assets (but less than substantially all its assets), it may, without any conceivable violation of the successor obligor provisions, distribute the proceeds of that sale to its stockholders, reinvest the proceeds in different operating assets, or simply retain the proceeds. Whichever action the obligor chooses, it remains obligated under the indenture, and debentureholders must then look to the new body of assets in whatever form or amount they then exist. This process can be repeated any number of times in the life of an indenture contract—and often is. After each sale (if it is of *less than* "substantially all"), the original obligor remains obligated and the assets that are pertinent to the ongoing relationship are the reconstituted body of assets.

In contrast, when an obligor at any given moment in time sells *all or substantially all* the assets then in its possession

(including any proceeds from prior sales of less than substantially all of its assets), the obligor must transfer the debt to the purchaser, and the purchaser becomes the new or "successor" obligor under the indenture. The assets that are then relevant to the new indenture relationship are those thus transferred, together with the additional assets of its own that the purchaser brings to this new relationship. In such circumstances, the fact that, as the Second Circuit suggested, the seller still retains assets in the form of the proceeds of the sale is irrelevant because, after it has sold all or substantially all of its assets (including any proceeds from prior sales of less than substantially all), it can no longer be the obligor. As the Second Circuit itself recognized, "a borrower which sells all its assets does not have an option to continue holding the debt." 691 F.2d at 1050; App. A at 22a. In short, Sharon Steel's "literalist" approach does not contain the fallacy asserted by the Second Circuit. Once an obligor has sold all, the debt has to travel with those assets, and the fact that the seller retains the proceeds from the sale of all has no significance under the indenture.

Sharon Steel respectfully suggests that the Second Circuit fails to come to grips with the fact that the successor obligor provision speaks in the present. It looks neither backward nor forward. It does not require the obligor to sell assets it no longer possesses, nor assets that it does not yet possess. It is sufficient that the obligor sells all that it has at a time when no default exists and the indenture is in full force and effect.[12]

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12 Of course, we are not here talking about sham or fraudulent transactions, and no one has ever asserted that there was anything sham or fraudulent about the Sharon Steel/UV transaction. As was fully explained below, there are adequate safeguards, such as fraudulent conveyance laws, *see, e.g.*, Uniform Fraudulent Conveyance Act §§ 1-12; N.Y. Debtor & Creditor Law §§ 270-81 (McKinney 1977), that protect creditors against sham or fraud, as well as specific indenture provisions (such as dividend restrictions, asset restrictions, and net worth requirements) that explicitly act as bulwarks against an obligor's selling its assets in a series of transactions and then selling an infinitesimal amount of remaining assets to a purported successor obligor.

In the Sharon Steel/UV transaction, of course, there was nothing infinitesimal about the assets UV sold to Sharon Steel: they exceeded half a billion

That is the plain meaning of the standard successor obligor provision.

B. The Second Circuit's Policy Considerations are Misconceived

Finding, erroneously, that Sharon Steel's "literalist" approach "proves too much", the Second Circuit moved on to its broad policy analysis. That analysis also entails erroneous assertions. For example, during its appeal Sharon Steel set forth for the Second Circuit numerous types of corporate transactions which could severely dilute the interest of debentureholders, yet would be totally proper under the standard successor obligor provision. The only distinction between these examples and the instant case is that the former do not involve the adoption of a plan of voluntary liquidation.

The Second Circuit suggests that this distinction is crucial because, in its view, in corporate transactions that do not involve liquidations the self-interest of the obligor's shareholders provides protection for debentureholders that is absent when a voluntary liquidation plan is involved. 691 F.2d at 1050; App. A at 23a-25a. Apparently, the Second Circuit viewed this distinction as necessitating an interpretation that transforms the successor obligor provision into a pervasive restriction which affects asset sales when a plan of voluntary liquidation is adopted (an event nowhere even referred to or given any significance in any of the Indentures), but which has no effect on numerous other corporate dispositions or combinations.[13] The Second Circuit's distinction is misconceived.

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dollars. However, even assuming it were appropriate to look to any date other than the date of the sale to Sharon Steel, the plain fact is that, with one exception (an initial liquidating distribution on April 30, 1979, that strictly complied with dividend restrictions in one of the Indentures), Sharon Steel acquired all the assets UV held when the liquidation plan was adopted or the proceeds from the sale of those assets.

13 The effect of the Second Circuit's interpretation of the successor obligor provision is that, once an obligor adopts a plan of voluntary liquidation, it is automatically prohibited from effecting any further signifi-

The Second Circuit suggests that when a merger is involved, rather than a sale of assets after the adoption of a voluntary liquidation plan, the self-interest of the obligor's shareholders protects debentureholders from a new obligor with a "substantially greater danger of insolvency." 691 F.2d at 1050; App. A at 23a. That may be so if the merger results in an exchange of stock for stock, but clearly is not the case if it is a cash merger, *i.e.*, where the shareholders' interest is bought for cash. In the latter case the self-interest of the shareholders is directly contrary to the interest of the debentureholders in that the shareholders will want to obtain from the new obligor as much cash as possible and will have no interest in the new obligor.

The fallacy of the Second Circuit's distinction is that it focuses on the form of a transaction rather than the substance. Whether the self-interest of shareholders will provide any degree of protection to debentureholders does not depend on whether the transaction in issue is a merger, a sale of assets followed by adoption of a liquidation plan, or a sale of assets preceded by one. It depends entirely on whether the old obligor's shareholders take an interest in the new obligor (in the form of equity or debt) or whether they are cashed out.

In sum, the Second Circuit's "proves too much" argument and its policy analysis lack any support within the four corners of the Indentures and are based on a misconception of the effects of various types of corporate reorganizations.

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cant change in either the quantity or quality of its assets without repaying the debentures. Under this theory, these broad restrictions arise although they are nowhere specified in the indentures and despite the fact that such restrictions are explicitly spelled out in indentures in which their inclusion is intended. Inexplicably, these restrictions would not arise if an obligor engaged in a series of transactions identical to UV's, but did so pursuant to a merger plan, a reorganization plan, or even a liquidation plan adopted *after* the final sale or combination of assets.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

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